State Tax Commission

Elk Ranches

Production Exemption Guidance

This document is intended to give a brief background on the production exemption and provide practical guidance to elk ranches that raise elk on private land for the purpose of offering guided hunt packages to customers. The document's primary focus is to explain how such businesses must structure their operations to qualify for the sales tax production exemption.

Background

Granting sales and use tax exemptions rests exclusively with the Idaho Legislature. The commonly referenced "production exemption" (Idaho Code § 63-3622D) is one of the most widely used exemptions.

The logical need for the production exemption was expressed when the original Sales and Use Tax Act was enacted in 1965:

> The function of this section is to establish a conceptual exemption for materials, machinery and equipment used or consumed in the production process. The design of this section is to equate the purchase for manufacturing or production purposes with resale exemption applied to the purchase of finished goods. If the goods which are produced by mining, farming or manufacturing are to be resold, then the material, machinery and equipment entering into their make-up should be exempt. (House Revenue and Taxation Committee Report in Support of House Bill 222, Section 22. 1965).

Two years later, in 1967, the Legislature amended the production exemption to provide that property exempt under the production exemption must be used by a business or segment of a business which is primarily devoted to a production operation. Forty-six years later, some businesses with minor production functions still question why they are unable to take advantage of the production exemption.

The production exemption carries with it a business' sweeping ability to purchase goods tax exempt through claim forms that remain on file with vendors and, without human intervention in modern "point of sale" accounting systems, routinely triggers vendors to sell goods exempt from tax. Since a multi-faceted business has activities that don't qualify for the production exemption, purchases create and carry with them an administrative problem—a vendor is unable to know how a purchaser may use goods.

In an attempt to remove the difficult problems associated with discriminating and classifying items that are production exempt from those that are not, the legislature's inclusion of its "separately operated segment of a business" (Idaho Code § 63-3622D(b)) language eases the administrative burden of the vendors and lessens their exposure to adverse audit findings. It also aids the Tax Commission in its enforcement role.

The discrimination and classification problem led the legislature to hold the purchase, sale and use of all hand tools not in excess of $100 taxable regardless of how critical their role may be in production (Idaho

Code § 63-3622D(b)). Administratively, it would be far more efficient if the Legislature required all businesses engaged in production of goods for resale to operate those segments under legally assumed names different from their primary business. Compliance would be enhanced, and fewer innocent mistakes would be made by vendors and buyers.

How a Business Can Qualify for the Production Exemption

The production exemption is one of the rare sales tax exemptions for which the business or a separately operated segment of the business must qualify before an exempt purchase can be made. The business or separately operated segment of the business must be primarily devoted to the production of tangible personal property for resale. If that requirement is not met, no purchases will be exempt under the production exemption.

For ranches offering guided elk hunt packages, the Tax Commission has agreed that the hunt package includes the sale of an elk if the customer is guaranteed either elk meat or a trophy from the kill. In those cases, the elk themselves can be purchased by the business for resale.

However, the Commission has generally taken the stance that the overall business is primarily devoted to the recreational aspects of the business (the recreational experience including the guided hunt, lodging, and prepared meals) rather than the production (breeding and raising the elk). As a result, a lot of questions have arisen asking if it’s possible to structure the business in a different way that would allow the business to qualify for the production exemption. There are two common methods to accomplish this purpose.

Method # 1. Create two separate legal entities (corporation, LLC, S corporation, etc.) with separate financial records. All business expenses and activities related to the raising of the elk, such as elk feed or labor to raise the elk, should fall under one entity. All business expenses and activities related to the sale of the elk hunt package should fall under the other entity. Though the ownership of the two entities may be the same, one business sells its product to the other in a recorded transaction. In examining the first entity, it will clearly qualify for the production exemption as it is primarily, even exclusively, devoted to the production of tangible personal property (elk) for resale.

Method # 2. Create a separately operated segment for the elk raising activities within the existing business. Sales tax administrative rule 079.02.a gives guidance on specific requirements that an auditor would expect to see (emphasis added):

> a. For the purposes of this rule, a separately operated segment of a business is a segment of a business for which **separate records** are maintained and which is operated by an employee or employees whose **primary employment responsibility** is to operate the business segment.

Separate records primarily refer to accounting records; however, combining of any records should be avoided where possible. When these requirements are met, the activity of the segment will be analyzed on its own for purposes of the production exemption. If the segment is primarily devoted to the production of elk for resale, that segment of the business may make certain purchases exempt under the production exemption.

In closing, it is important to note that to qualify for the production exemption, there is a requirement to affect some change to the goods being produced. For example:

- A business that has a separate company or a separate division that primarily breeds, raises, and sells elk to other companies or that primarily processes elk into meat which is then sold at retail or wholesale would likely qualify.
- A business or division that purchases young elk, raises them into mature animals, and sells them to a hunting/bull shooter company would likely qualify.

However, an operation that purchases mature animals and simply maintains the animals until they are needed for the guided hunt probably would not qualify regardless of how the business is structured.

Other Information

This document is not intended to cover the application of the production exemption to specific purchases. For more details, please review Idaho Code § 63-3622D and Sales Tax Administrative Rule 079.

For additional help:

- Visit our website, tax.idaho.gov
- Contact McLean Russell at (208) 334-7531